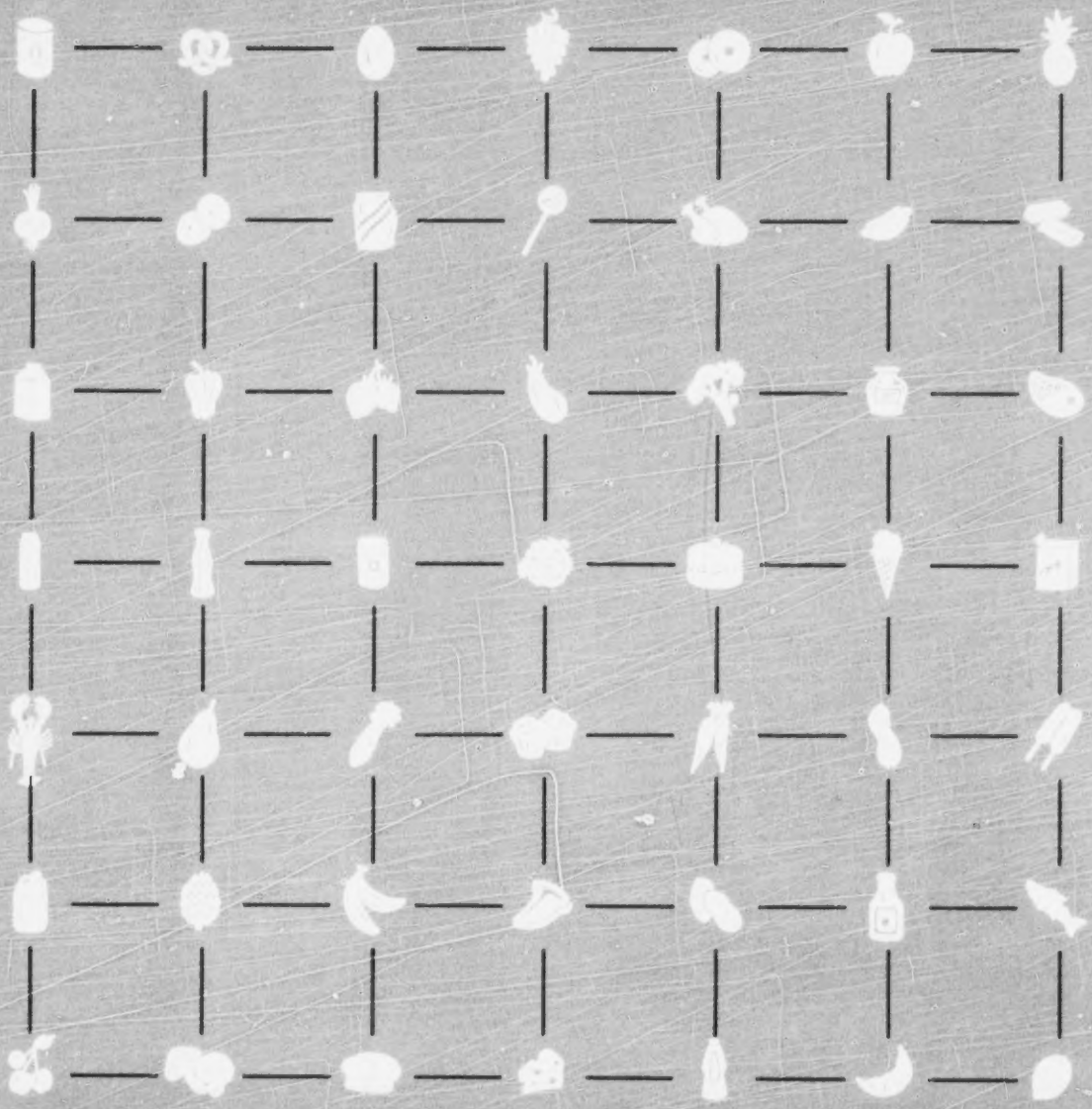
1985/1986

ANNUAL FINANCIAL REVIEW



The Annual Report of the Supermarket Companies

FMI

FOOD MARKETING INSTITUTE

1985/1986

ANNUAL FINANCIAL REVIEW

The Annual Report of the Supermarket Companies

Conducted by:

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for the Research Division
FOOD MARKETING INSTITUTE
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Washington, DC 20006

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Williams-Keepers
Certified Public Accountants

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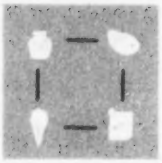
The Food Marketing Institute (FMI) is a non-profit association that conducts programs in research, education and public affairs on behalf of its 1500 members—food retailers and wholesalers and their customers. FMI's domestic member companies operate more than 17,000 retail food stores with a combined annual sales volume of $130 billion—half of all grocery sales in the United States. More than three-fourths of the FMI membership is composed of independent supermarket operators or small regional firms. Its international membership includes more than 100 members from 40 nations.

CONTENTS



Executive Summary 1

Financial Data and Ratios 2

Selected Economic Data 2
- Consumer Price Index—all urban consumers
- Consumer Price Index—food-at-home
- Average Prime Rates Charged by Banks

Key Financial Ratios 4
- Profit Margin
- Return on Total Assets
- Return on Net Worth

Key Financial Ratios by Company Size 5
- Profit Margin
- Return on Total Assets
- Return on Net Worth

Key Financial Ratios Adjusted for Inflation 6
- Profit Margin
- Return on Total Assets
- Return on Net Worth

Tax Rates 8

Financial Statements 9
- Income Statement 9
- Balance Sheet 10

Comparison: Historical vs. 12
- Inflation-Adjusted
- Balance Sheet Categories

Inflation Adjustments 14

Methodology 16
- Approach

Definitions 18

EXECUTIVE SUMMARY

The Food Marketing Institute (FMI) has been tracking the performance of the supermarket industry for the past 14 years. The 1985/86 Annual Financial Review (the "Review") was designed to promote a better understanding of the economics of the supermarket industry.

The Review was conducted for FMI by Gerke Economics, Inc. Information was derived from an extensive mail survey and from public financial reports. Data were collected from 131 companies operating over 12,000 supermarkets.

The results of the Review indicate that average supermarket company profit margins in 1985/86 were about the same as the previous year, while return on net worth gained almost one full percentage point. Net income as a percentage of sales was 1.19 percent in 1985/86 versus 1.15 percent in 1984/85.

Profit performance varied by company size. The small firms showed a healthy increase in profitability. Profits for mid-size and large firms were about the same as the previous year.

Profit Margin
Net Income After Taxes as a Percent of Sales

	1984/85	1985/86
Sales Under $50 Million	0.78%	1.01%
Sales Between $50 and $500 Million	0.83%	0.81%
Sales Over $500 Million	1.36%	1.32%

FINANCIAL DATA AND RATIOS

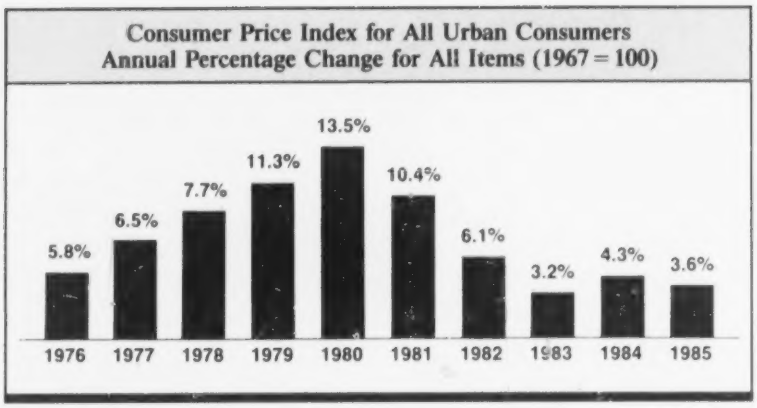
Selected Economic Data

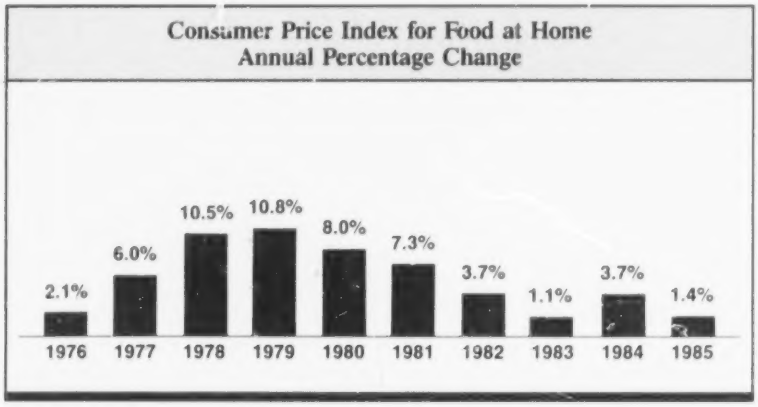
During 1985, the U.S. economy continued to recover from the most severe recession since the great depression.

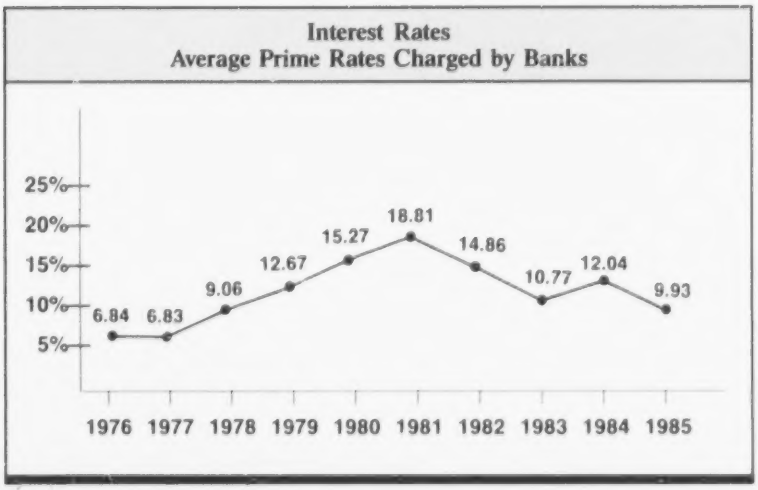
Inflation, as measured by the consumer price index for all urban consumers, was 3.6 percent, a slight decrease from 1984. The consumer price index for food-at-home rose only 1.4 percent in 1985.

Interest rates dropped considerably during 1982 and 1983, increased slightly in 1984 and dropped again in 1985. The average monthly prime rate charged by banks in 1985 ranged from 9.5 percent to 10.6 percent.

With inflation at about 4 percent and the prime rate hovering around 10 percent, "real" interest rates in 1985 were considerably above historical levels of 3 percent to 4 percent.


Consumer Price Index for All Urban Consumers
Annual Percentage Change for All Items (1967 = 100)
5.8%
6.5%
7.7%
11.3%
13.5%
10.4%
6.1%
3.2%
4.3%
3.6%
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985


Consumer Price Index for Food at Home
Annual Percentage Change
2.1%
6.0%
10.5%
10.8%
8.0%
7.3%
3.7%
1.1%
3.7%
1.4%
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985


Interest Rates
Average Prime Rates Charged by Banks
25%
20%
15%
10%
5%
6.84
6.83
9.06
12.67
15.27
18.81
14.86
10.77
12.04
9.93
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985

Key Financial Ratios

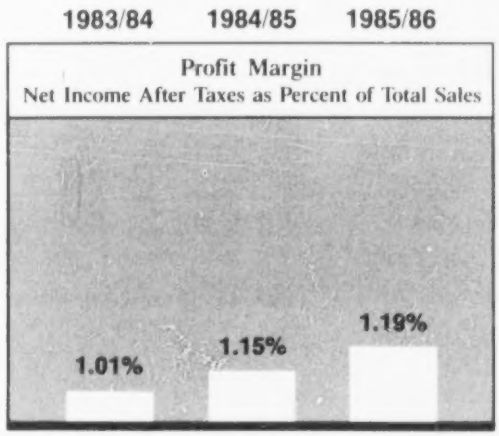
In measuring profitability, three financial ratios taken together provide an overall picture of the financial health of supermarket companies:

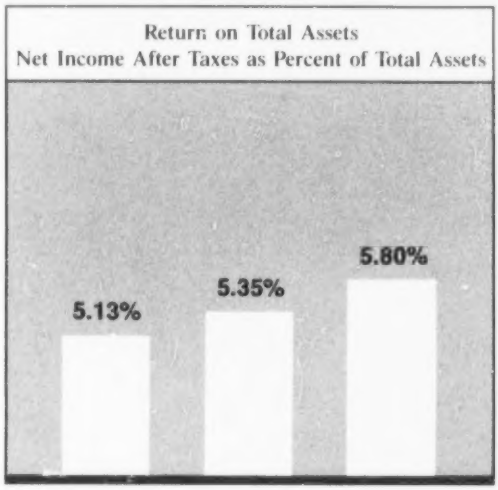
—profit margin
—return on total assets
—return on net worth

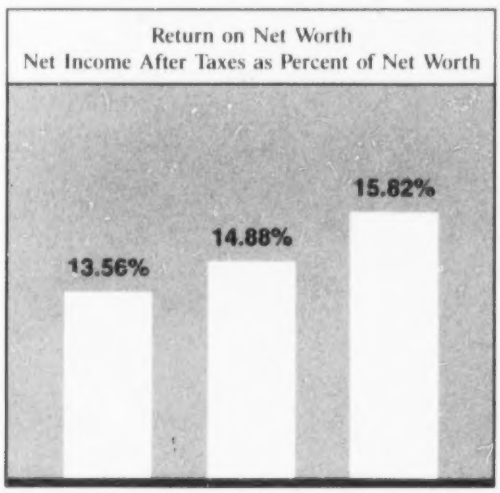
The profit margin is simply net income after taxes as a percentage of sales. It measures the portion of the firm's sales dollar that is left after paying all expenses, including the cost of the products. For the supermarket companies in 1985/86, the after tax profit margin was 1.19 percent. This is slightly higher than the 1.15 percent reported in 1984/85.

Return on total assets is calculated by expressing net income after taxes as a percentage of total assets. It measures the ability of a company's combined equity and debt capital to generate profits. In 1985/86 supermarket companies' return on total assets increased to 5.80 percent from 5.35 percent one year earlier.

Return on net worth is calculated by expressing net income after taxes as a percentage of net worth. It reflects the earning power of the stockholders' equity in supermarket companies. Return on net worth for supermarket firms was 15.82 percent in 1985/86, up from 14.88 percent for the previous year.







Key Financial Ratios by Company Size

Profit Margin
Net Income After Taxes as a Percent of Sales

	1984/85	1985/86
Sales Under $50 Million	0.78%	1.01%
Sales Between $50 and $500 Million	0.83%	0.81%
Sales Over $500 Million	1.36%	1.32%

Return on Total Assets
Net Income After Taxes as a Percent of Total Assets

	1984/85	1985/86
Sales Under $50 Million	5.86%	6.90%
Sales Between $50 and $500 Million	3.97%	3.86%
Sales Over $500 Million	5.75%	5.72%

Return on Net Worth
Net Income After Taxes as a Percent of Net Worth

	1984/85	1985/86
Sales Under $50 Million	16.35%	19.54%
Sales Between $50 and $500 Million	11.01%	10.24%
Sales Over $500 Million	15.64%	15.78%

Profit ratios were calculated for three company size categories based on annual sales of:

—less than $50 million
—$50 to $500 million
—more than $500 million

The smaller firms (sales under $50 million) showed a substantial increase in profitability from 1984/85 to 1985/86. The mid-size and larger firms showed a very slight decrease in profit margins.

In 1985/86, the largest firms had the highest profit margin, the smallest firms showed the highest return on total assets and return on net worth. Overall the mid-size firms showed the lowest profits.

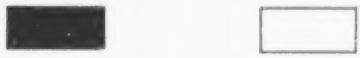
The small and medium sized firms had about the same profit margin before taxes. However, the smaller firms had a much lower effective tax rate resulting in a net profit margin after taxes above the mid-sized companies.

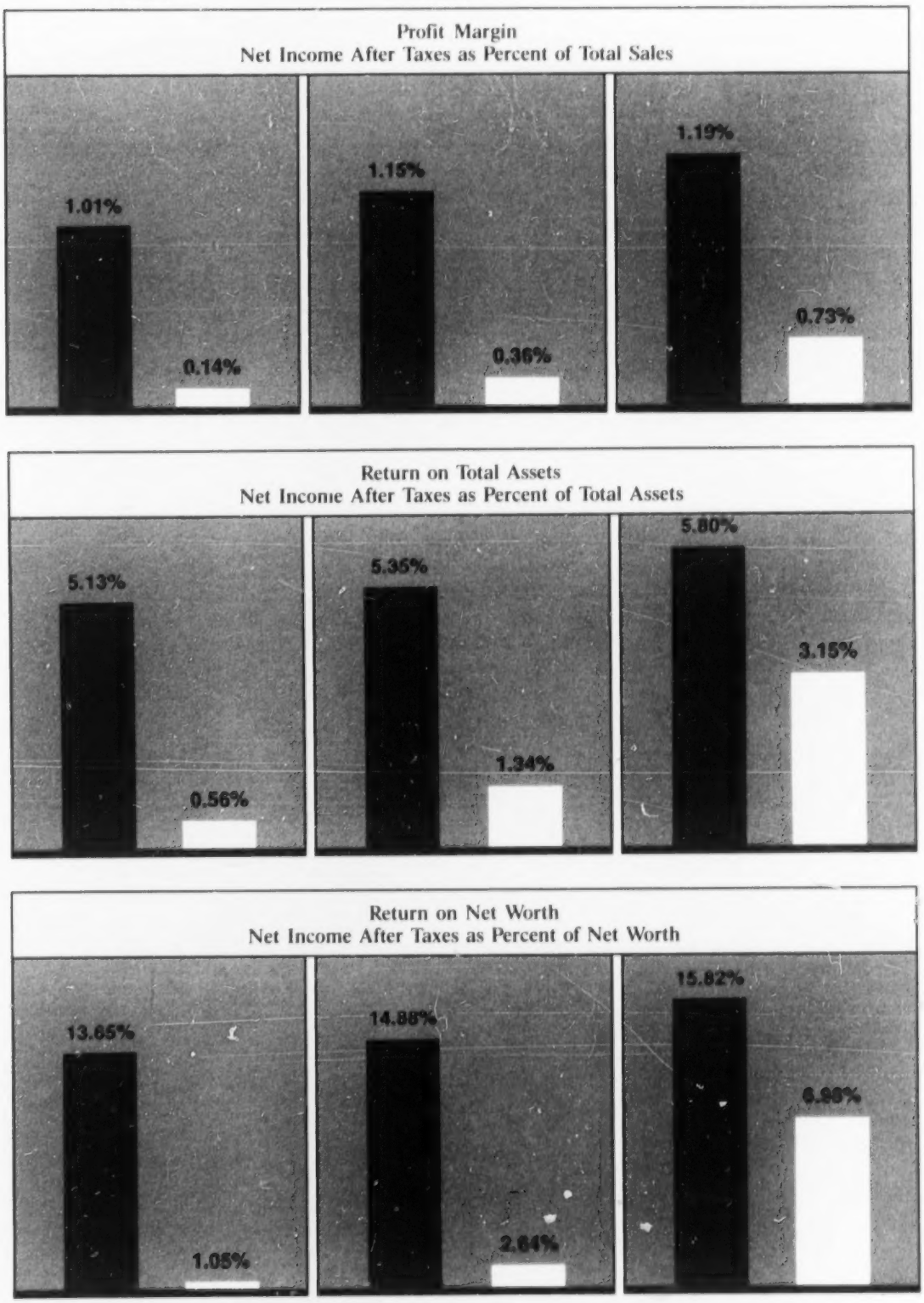
Key Financial Ratios Adjusted for Inflation

The performance measures discussed in the previous section are subject to distortion caused by inflation. For comparison, ratios are presented on an inflation-adjusted basis in order to more accurately reflect the economic well-being of supermarket firms.

The inflation adjustments used in the REVIEW are those prescribed by Statement of Financial Accounting Standards No. 33. Such adjustments restate "cost of sales" and "depreciation" from the amounts recorded in historical dollars to current dollars. In so doing, (1) the impact of profits realized on inventory is removed from the income statement, and (2) the depreciation charge is increased to reflect the current costs of replacing assets.

Low inflation during the past few years has brought real growth to the supermarket industry. The inflation-adjusted profit ratios have improved steadily the past three years. The profit margin, return on total assets and return on net worth were 0.73 percent, 3.15 percent and 6.98 percent respectively for 1985/86.




1983/84
1984/85
1985/86
Profit Margin
Net Income After Taxes as Percent of Total Sales
1.01%
0.14%
1.15%
0.36%
1.19%
0.73%
Return on Total Assets
Net Income After Taxes as Percent of Total Assets
5.13%
0.56%
5.35%
1.34%
5.80%
3.15%
Return on Net Worth
Net Income After Taxes as Percent of Net Worth
13.65%
1.05%
14.88%
2.64%
15.82%
6.98%

TAX RATES

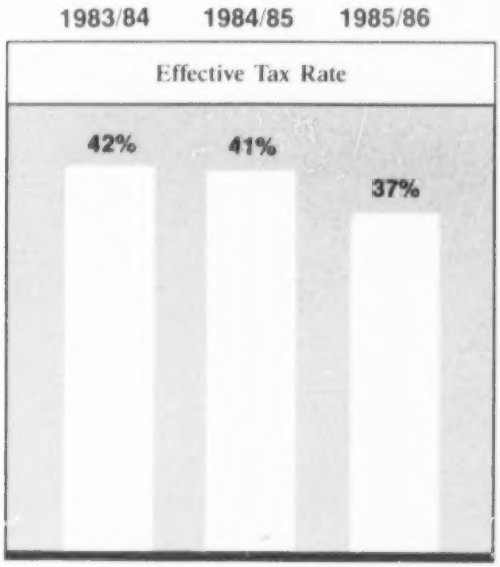
Income Taxes

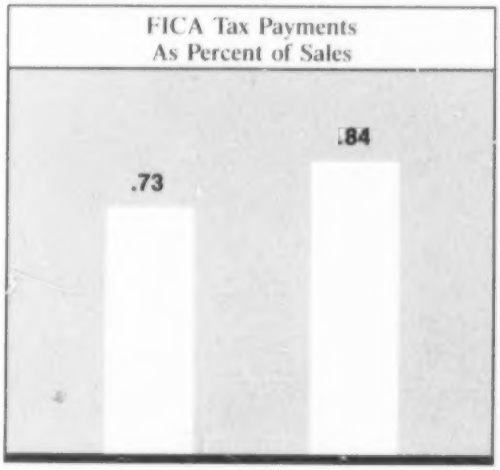
1985/86 income taxes paid by supermarket companies were 37 percent of pre-tax profits.

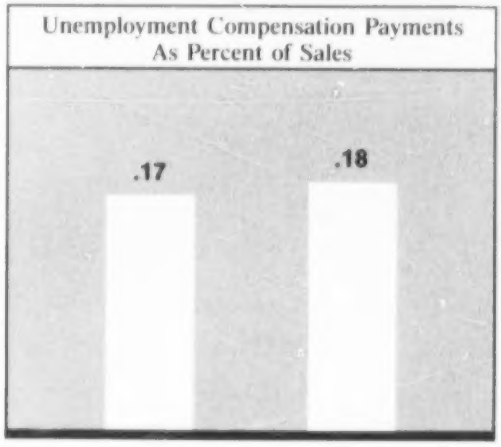
Income taxes affect corporations by consuming much of their "real" pre-tax profits. Income tax calculations for an individual company are based upon net income calculated on an historical cost basis. For tax reporting, no adjustments are made to reflect the erosion of purchasing power that occurs through inflation. For example, depreciation expense for equipment is based on its actual cost, rather than on the current cost of replacing it.

Wage Taxes

In addition to taxes on income, supermarkets pay taxes based on wages. Company data were collected for FICA tax payments and Unemployment Compensation payments. In 1985/86, FICA tax payments amounted to 0.84 percent of sales. Unemployment Compensation payments were 0.18 percent of sales.







FINANCIAL STATEMENTS

Income Statement

The account balances in the income statement presented below have been expressed as percentages of sales.

Income Statement for Supermarket Companies (In Percentages; Sales = 100%)			
	1983/84	**1984/85**	**1985/86**
Sales	100.00%	100.00%	100.00%
Cost of Sales and Operating Expenses	98.20	98.12	97.84
Interest Expenses	0.46	0.52	0.55
Total Costs & Expenses	98.66	98.64	98.39
Operating Income	1.34	1.36	1.61
Other Income	0.36	0.43	0.23
Income Before Taxes	1.70	1.79	1.84
Total Taxes on Income	0.71	0.74	0.68
Extraordinary Items (Net)	0.02	0.10	0.03
NET INCOME	**1.01**	**1.15**	**1.19**

Balance Sheet

The account balances in the balance sheet presented below have been expressed as percentages of total assets.

End-of-year Balance Sheet for Supermarket Companies (In Percentages; Total Assets = 100%)

ASSETS	1983/84	1984/85	1985/86
CURRENT ASSETS			
Cash	6.66%	6.26%	5.17%
Accounts Receivable	4.33	4.24	3.91
Marketable Securities	2.78	3.35	2.76
Inventory (Note A)	31.47	31.66	31.92
Other Current Assets	3.64	2.94	3.45
Total Current Assets	48.88	48.45	47.21
PROPERTY & EQUIPMENT (Note B)			
Land	2.93	3.80	3.92
Buildings	21.85	21.62	18.79
Fixtures & Equipment	44.07	43.52	47.88
Leasehold Improvements	10.08	10.35	9.77
Total Property & Equipment	78.93	79.29	80.36
Reserves for Depreciation	(33.23)	(33.18)	(33.93)
Net Property & Equipment	45.70	46.11	46.43
OTHER ASSETS	5.42	5.44	6.36
TOTAL ASSETS	100.00%	100.00%	100.00%

Note A: Some firms value at least part of their inventory on a LIFO (last-in, first-out) basis.

Note B: Property under capitalized leases is included in the appropriate property categories based on the type of property leased.

End-of-year Balance Sheet for Supermarket Companies (In Percentages; Total Liabilities & Net Worth = 100%)			
LIABILITIES & NET WORTH	1983/84	1984/85	1985/86
CURRENT LIABILITIES			
Notes Payable	2.12%	2.17%	2.71%
Accounts Payable	22.68	22.39	21.63
Income Taxes Payable	1.35	1.19	1.48
Other Current Liabilities	10.40	10.18	9.78
Total Current Liabilities	36.55	35.93	35.60
LONG-TERM DEBT			
Mortgages	4.80	5.57	6.11
Bank Loans	4.67	6.78	6.95
Bonds & Debentures	2.72	2.54	3.37
Capitalized Lease Obligations	8.59	7.35	5.90
Other Noncurrent Liabilities	2.69	3.16	2.61
Total Long-Term Debt	23.47	25.40	24.94
DEFERRED LIABILITIES	2.48	1.81	2.83
Total Liabilities	62.50	63.14	63.37
NET WORTH			
Common Stock Outstanding or Proprietorship	4.19	3.62	3.95
Preferred Stock Outstanding	0.65	1.00	0.77
Paid-in Surplus	4.98	5.61	4.87
Retained Earnings	29.39	27.94	28.87
Treasury Stock	(1.71)	(1.31)	(1.83)
Total Net Worth	37.50	36.86	36.63
TOTAL LIABILITIES & NET WORTH	100.00%	100.00%	100.00%

Historical vs. Inflation-Adjusted Balance Sheet Categories

Certain balance sheet categories were grouped and expressed as percentages of total assets, in both historical dollars and inflation-adjusted dollars. The most significant impact of the inflation adjustments was to restate (i.e. increase) the value of "net property and equipment" in current year dollars. (This increase was also added to "net worth"). These adjustments recognize that the current costs of replacing existing supermarket properties are significantly higher than the depreciated historical cost. Investors in supermarket properties are unable to realize those gains unless the company is dissolved or sold.

Balance Sheet Categories as Percent of Total—Historical Cost Basis

ASSETS	1983/84	1984/85	1985/86
Inventory	35%	35%	35%
Other Current Assets	17	16	15
Net Property & Equipment	43	44	44
Other Assets	5	5	6
Total	100%	100%	100%
LIABILITIES AND TOTAL NET WORTH			
Current Liabilities	40%	39%	39%
Long-Term Liabilities	25	26	26
Net Worth	35	35	35
Total	100%	100%	100%

Balance Sheet Categories as Percent of Total—Adjusted for Inflation			
ASSETS	1983/84	1984/85	1985/86
Inventory	27%	27%	30%
Other Current Assets	13	13	13
Net Property & Equipment	56	56	52
Other Assets	4	4	5
Total	100%	100%	100%
LIABILITIES AND TOTAL NET WORTH			
Current Liabilities	31%	30%	34%
Long-Term Liabilities	20	21	23
Net Worth	49	49	43
Total	100%	100%	100%

Inflation Adjustments

The Financial Accounting Standards Board (the "FASB") has recognized that financial statements prepared on the basis of historical costs may not be meaningful in times of rapid inflation. As a result, Statement of Financial Accounting Standards No. 33 requires large companies to present data which reflect the impact of inflation. One method prescribed in SFAS No. 33 is to adjust cost of sales and depreciation from the amounts recorded in historical dollars to current year dollars. This approach, called constant dollar accounting, removes the effect of inventory profits on cost of sales from the income statement, and increases the depreciation charge to amounts reflective of the current cost of replacing assets. The Consumer Price Index for All Urban Consumers is used to make such adjustments.

After adjusting for the effects of inflation on cost of sales and depreciation, supermarket companies achieved a slight profit margin in 1985/86 of 0.73 percent of sales. The substantial increase from 0.14 percent in 1983/84 to 0.73 percent in 1985/86 is due mainly to lower inflation rates.

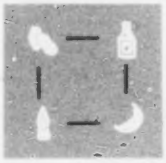
Net Income for Supermarket Companies Adjusted for Inflation (Expressed as a Percent of Sales)

	1983/84	1984/85	1985/86
Net income, historic basis	1.12%	1.26%	1.25%
Adjustments to reflect the impact of inflation on:			
Cost of sales	(0.28)	(0.31)	(0.16)
Depreciation	(0.70)	(0.59)	(0.36)
Net income adjusted for inflation	**0.14%**	**0.36%**	**0.73%**

It is important, however, to consider one additional element during periods of inflation—gain or loss in purchasing power. In times of inflation, businesses that hold cash may be at a disadvantage in terms of general purchasing power because their cash will buy less at the end of the period than at the beginning. On the other hand, entities that have debts during inflationary periods may gain an advantage because their debts will be repaid with dollars of lower purchasing power. Statement of Financial Accounting Standards No. 33 requires that the net of these gains and losses be disclosed separately from income from continuing operations. This separate disclosure requirement reflects the FASB's concern that a company can gain from borrowing. (The FASB believed that a gain in purchasing power associated with debt is a sign of successful management only when the funds have been invested in assets that maintain their purchasing power.) As a result, the gains in purchasing power that the supermarket firms have realized on monetary items have not been reflected in the inflation-adjusted data that have been previously presented in this report. The substantial increase from 0.48 percent in 1983/84 to 1.03 percent in 1985/86 is due mainly to lower inflation rates. These data, however, have been included in the following table.

Net Income for Supermarket Companies Adjusted for Inflation (Expressed as a Percent of Sales)

	1983/84	1984/85	1985/86
Net income, historic basis	1.12%	1.26%	1.25%
Adjustments to reflect the impact of inflation on:			
Cost of sales	(0.28)	(0.31)	(0.16)
Depreciation	(0.70)	(0.59)	(0.36)
Purchasing Power	0.34	0.38	0.30
Net income adjusted for inflation	**0.48%**	**0.74%**	**1.03%**



METHODOLOGY

Approach

The ANNUAL FINANCIAL REVIEW was developed from two primary sources of data: a survey mailed to the members of FMI and annual reports filed with the SEC on FORM 10-K.

For 1985/86, most of the financial data were supplied by the companies that responded to the survey. Data were not used for any company with sales of less than $2 million per store. Only firms with at least 50 percent of revenues from supermarkets were included in the sample.

Data for several large publicly traded companies were obtained from annual reports filed with the SEC. In all, data were collected from 131 companies that operated 12,343 stores. These firms accounted for sales of $125 billion.

The sample of firms in this survey included 54 companies with sales under $50 million, 41 companies with sales $50 to $500 million, and 36 companies with sales over $500 million. The sample size in this survey varies from year to year. The variation in the sample will be greatest among the smaller firms. Some of the year to year changes in profitability may be due to a change in the companies responding to the survey.

In the sample of companies included in this REVIEW, over 97 percent of the sales of small and medium sized companies were through supermarkets. On aver-

age, the larger firms generated 91 percent of their revenues from supermarkets and 9 percent from other sources.

Financial data were collected for company fiscal years ending between April 1, 1985 and March 31, 1986.

The firms were separated into two size categories based on annual sales—companies with less than $100 million, and companies with $100 million and over.

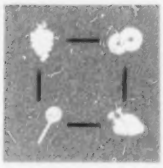
In order to develop the industry averages reported, means were calculated for each strata (size category) and were weighted using data from the 1982 Census of Retail Trade. The Census data are shown in the table below. The stratification and weighting of data help eliminate year-to-year changes that result from changes in the sample of firms submitting surveys.

We believe this method of developing average financial estimates for supermarket companies provides the best published measurement of trends in the supermarket industry's capital structure. It does not, however, totally eliminate the problems of changes in sample size, and varying fiscal year ends.

Supermarket Population Based on 1982 Census of Retail Trade*

Firm Sales (Millions)	% of Total Firms	1982 Sales	% of Total Sales
Less than $100	97.4	$ 57,792,633	30.25
$100 and Over	2.6	$133,268,115	69.75
	100.00%	**$191,060,748**	**100.00%**

*Source: U.S. Census Bureau (latest available data)



DEFINITIONS

SELECTED BALANCE SHEET CAPTIONS

INVENTORY includes all goods held for sales by supermarket companies. Some firms value inventories on a First-In First-Out basis. Others use a Last-In First-Out basis of valuation. For this Review the inventories are recorded as reported by the surveyed companies.

OTHER CURRENT ASSETS include all assets (except inventory) with a defined life of less than one year (e.g., cash, accounts receivable, prepaid expenses, short-term investments, etc.).

NET PROPERTY & EQUIPMENT is all property, plant and equipment, including capital leases, less accumulated depreciation and amortization.

OTHER ASSETS include all assets (except property and equipment) with a defined life greater than one year (e.g., investments in other companies, long-term receivables, etc.).

CURRENT LIABILITIES include all debts and expenses which are due within one year (e.g., accounts payable, accrued liabilities, current portions of long-term debt, etc.).

LONG-TERM LIABILITIES include all debts and expenses which are due after one year (e.g., long-term debt, capital lease obligations, deferred taxes, etc.).

NET WORTH is the difference between total assets and total liabilities. It is typically comprised of stock, paid-in-surplus, retained earnings and treasury stock.

SELECTED INCOME STATEMENT CAPTIONS

SALES represent all sales reported by supermarket companies.

COST OF SALES AND OPERATING EXPENSES include the cost of merchandise sold by supermarkets plus all other expenses of operating the stores, distribution facilities, and the central office.

INTEREST EXPENSE includes all interest charged on short- or long-term debt and on capital lease obligations.

OTHER INCOME includes all non-operating income (e.g., interest income, gain on sale of securities, etc.).

TOTAL TAXES ON INCOME are the Federal and state taxes imposed on the supermarket companies which are based on net income as reported to the government.

EXTRAORDINARY ITEMS include all items which occur infrequently and are unusual in nature (e.g., provisions for the disposition of facilities, realization of tax loss carry forwards, etc.).

RATIOS

PROFIT MARGIN is the ratio of net income to sales.

RETURN ON TOTAL ASSETS is the ratio of net income to total assets.

RETURN ON NET WORTH is the ratio of net income to net worth.

INFLATION ADJUSTMENTS

INFLATION ADJUSTED NET INCOME is equal to net income as reported in historical dollars, less "constant dollar" adjustments to reflect the impact of inflation on (1) cost of sales (i.e., to remove the effect of inventory profits from cost of sales) and (2) depreciation (i.e., to increase the depreciation charge to reflect the current cost of replacing assets).

For this REVIEW, inventory is adjusted for inflation with the percent change in the Consumer Price Index food-at-home from December to December.

Depreciation expense is adjusted for inflation by a percent change in the Consumer Price Index since the year the depreciable property was acquired. The year of acquisition is estimated by dividing accumulated depreciation charges by annual depreciation expense to estimate average age of depreciable assets.

CONSTANT DOLLAR ACCOUNTING is a method of reporting financial elements in dollars which have the same general purchasing power.

MONETARY ITEMS are assets or liabilities which will be realized or paid for in cash for the exact amount of the amounts recorded on the balance sheet.

NON-MONETARY ITEMS are assets or liabilities which cannot be converted directly to cash for the amount recorded on the balance sheet (e.g., inventory, property and equipment, deferred credits, etc.).

PURCHASING POWER GAIN OR LOSS is normally found by restating in constant dollars the (1) opening and closing balance of monetary assets and liabilities, and (2) transactions in monetary assets and liabilities. For this review the gain/loss from purchasing power is based on the net difference between monetary assets and monetary liabilities times the annual percent increase in the Consumer Price Index.

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